



Institute of Actuaries of India

Subject
CB2 – Business Economics
Core Principles
For 2022 Examinations

CB2 – Business Economics

Aim

The aim of the Business Economics subject is to introduce students to the core economic principles and how these can be used in a business environment to help decision-making and behaviour.

It provides the fundamental concepts of microeconomics that explain how economic agents make decisions and how these decisions interact.

It explores the principles underlying macroeconomics that explain how the economic system works, where it fails and how decisions taken by economic agents affect the economic system.

Competences

On successful completion of this subject, a student will be able to:

- 1 show a systematic knowledge and critical awareness of economic theory in the areas of syllabus covered by the subject.
- 2 apply a range of techniques to solve problems in the areas of syllabus covered by the subject.
- 3 appreciate recent developments and methodologies in economics.
- 4 understand the relevance of economic theory to the business environment and the links between economic theory and its application in business.
- 5 apply basic microeconomic and macroeconomic theory to business problems.

Links to other subjects

CB1 – Business Finance

CB3 – Business Management

CM2 – Financial Engineering and Loss Reserving

CP1 – Actuarial Practice

SP5 – Investment and Finance Principles

Other Specialist Principles subjects and all the Specialist Advanced subjects require the use of economic judgement.

Syllabus topics

- 1 Economic models and recent historical applications (10%)
- 2 Microeconomics (45%)
 - Behaviour of consumers
 - Behaviour of firms
 - Behaviour of markets.
- 3 Macroeconomics (45%)
 - Relationships between governments, markets and firms
 - Government policies
 - International trade.

These weightings are indicative of the approximate balance of the assessment of this subject between the main syllabus topics, averaged over a number of examination sessions.

The weightings also have a correspondence with the amount of learning material underlying each syllabus topic. However, this will also reflect aspects such as:

- the relative complexity of each topic and hence the amount of explanation and support required for it.
 - the need to provide thorough foundation understanding on which to build the other objectives.
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- the extent of prior knowledge that is expected.
- the degree to which each topic area is more knowledge- or application-based.

Skill levels

The use of a specific command verb within a syllabus objective does not indicate that this is the only form of question that can be asked on the topic covered by that objective. The Examiners may ask a question on any syllabus topic using any of the agreed command verbs, as are defined in the document 'Command verbs used in the Associate and Fellowship written examinations'.

Questions may be set at any skill level: Knowledge (demonstration of a detailed knowledge and understanding of the topic), Application (demonstration of an ability to apply the principles underlying the topic within a given context) and Higher Order (demonstration of an ability to perform deeper analysis and assessment of situations, including forming judgements, taking into account different points of view, comparing and contrasting situations, suggesting possible solutions and actions and making recommendations).

In the CB2 subject, the approximate split of assessment across these three skill types is 40% Knowledge, 45% Application and 15% Higher Order skills.

Detailed syllabus objectives

1 Economic models and recent historical applications (10%)

- 1.1 Discuss the relevance of economics to the world of business.
 - 1.1.1 Describe what is meant by opportunity cost and scarcity and their relevance to economic choice.
 - 1.1.2 Discuss the core economic concepts involved in choices made by businesses relevant to selection of outputs, inputs, technology, location and competition.
 - 1.1.3 Contrast microeconomics and macroeconomics.
- 1.2 Assess the main strands of economic thinking:
 - Classical
 - Marxian socialism
 - Neo-classical, Keynesian, neo-Keynesian and post-Keynesian
 - Monetarist
 - Austrian.
- 1.3 Analyse the recent macroeconomic history.
 - 1.3.1 Describe the progress of the world economy since the Great Depression, with a particular focus on:
 - a history of banking crises and irrational behaviour.
 - consequences of banking crises.
 - 1.3.2 Discuss the banking crisis of 2008, the Great Recession, and recovery.
 - 1.3.3 Describe the effectiveness of monetary policy in the 2008 financial crisis and the governments' actions to combat recession.
 - 1.3.4 Discuss the aftershocks in Europe following the 2008 financial crisis.
 - 1.3.5 Assess the stimulus–austerity debate and regulatory action after the 2008 crisis.

2 Microeconomics – the behaviour of consumers, firms and markets (45%)

- 2.1 Discuss the workings of competitive markets.
 - 2.1.1 Discuss how the markets operate.
 - Explain the role of the price mechanism in a free market.
 - Discuss the behaviour of firms and consumers in such markets.
 - 2.1.2 Describe the factors that influence the market demand and supply.
 - 2.1.3 Describe and discuss how market equilibrium quantity and price are achieved.
 - 2.1.4 Discuss how markets react to changes in demand and supply.
 - 2.1.5 Define and calculate price and income elasticities of demand and price elasticity of supply.
 - Calculate elasticities of demand using both original and average quantities.

- 2.1.6 Discuss the factors that affect elasticity.
- 2.1.7 Explain the effect of elasticity on the workings of markets in the short and long run.
- 2.1.8 Discuss how firms deal with risk and uncertainty about future market movements.
- 2.1.9 Describe price expectations and speculation and how price bubbles develop.
- 2.2 Discuss consumer demand and behaviour.
 - 2.2.1 Describe the concept of utility and representation of consumer preferences as indifference curves.
 - 2.2.2 Discuss rational choice and how optimal consumption choice is determined by using indifference curves and budget lines.
 - 2.2.3 Discuss the concepts of rational choice, perfect information and irrational behaviour in behavioural economics.
- 2.3 Discuss the importance of advertising for a firm.
 - 2.3.1 Explain the effects of advertising on sales and demand.
- 2.4 Discuss the production function, costs of production, revenue and profit in order to understand a firm's price and output decisions.
 - 2.4.1 Explain how the production function reflects the relationship between inputs and outputs in the short and long run.
 - 2.4.2 Define average and marginal physical product.
 - 2.4.3 Describe the meaning and measurement of costs and explain how these vary with output in the short and long run.
 - 2.4.4 Define total, average and marginal costs.
 - 2.4.5 Describe what is meant by 'economies of scale' and explain the reasons for such economies and how a business can achieve efficiency in selecting the level of its inputs.
 - 2.4.6 Describe revenue and profit and explain how both are influenced by market conditions.
 - 2.4.7 Define and calculate average and marginal revenue.
 - 2.4.8 Describe how profit is measured and explain how the firm arrives at its profit-maximising output.
 - 2.4.9 Explain what is meant by the 'shut-down' point in the short and long run.
- 2.5 Discuss profit maximisation under perfect competition and monopoly.
 - 2.5.1 Explain what determines the market power of a firm.
 - 2.5.2 Describe the main features of a market characterised by perfect competition.
 - 2.5.3 Explain how output and price are determined in such markets in the short and long run.
 - 2.5.4 Describe how monopolies emerge, how a monopolist selects its profit-maximising price and output and how much profit a monopolist makes.
 - 2.5.5 Describe the barriers to entry in an industry and a contestable market and explain how these affect a monopolist's profit.
- 2.6 Discuss profit maximisation under imperfect competition.
 - 2.6.1 Describe the behaviour of firms under monopolistic competition and explain why in this type of market only normal profits are made in the long run.
 - 2.6.2 Describe the main features of an oligopoly and explain how firms behave in an oligopoly.
 - 2.6.3 Discuss what determines competition and collusion of firms in an oligopoly and how the strategic decisions of such firms can be explained by game theory.
 - 2.6.4 Discuss whether firms in an oligopoly act in consumers' interest.
- 2.7 Assess various pricing strategies that firms in the financial services sector can adopt.
 - 2.7.1 Describe how prices are determined in practice and factors that affect the ability of a firm to determine its prices.
 - 2.7.2 Describe average-cost pricing and price discrimination.
 - 2.7.3 Discuss the pricing strategy for multiple products and explain how pricing varies with the stage in the life of a product.

3 Macroeconomics – relationships between governments, markets and firms, government policies and international trade (45%)

- 3.1 Discuss the reasons for government intervention in the market.
 - 3.1.1 Explain and discuss the extent to which businesses meet the interests of consumers and society in general.
 - 3.1.2 Explain in what sense perfect markets are 'socially efficient' and why most markets fail to achieve social efficiency.

- 3.1.3 Explain why externalities can lead to inefficient markets.
 - 3.1.4 Describe the ways in which governments intervene in markets in order to influence business behaviour, and explain the drawbacks of such intervention.
 - 3.1.5 Explain and discuss whether taxation or regulation could be more useful in correcting markets' shortcomings.
 - 3.1.6 Explain why government intervention might not improve market outcomes in practice even if the existence of 'market failures' suggest they can in theory.
 - 3.2 Discuss the relationship between the government and the individual firm.
 - 3.2.1 Describe the main targets of 'competition policy' and explain the extent to which it is effective.
 - 3.2.2 Explain why a free market fails to achieve the optimal amount of research and development.
 - 3.2.3 Describe the various forms of intervention that the government can undertake in order to encourage technological advance and innovation.
 - 3.3 Discuss globalisation and multinational business.
 - 3.3.1 Describe what is meant by globalisation and its impact on business.
 - 3.3.2 Explain what is driving the process of globalisation and whether the world benefits from globalisation of business.
 - 3.4 Discuss the importance of international trade.
 - 3.4.1 Describe the growth of international trade and its benefits to countries and firms.
 - 3.4.2 Explain the advantages of specialisation.
 - 3.4.3 Discuss the arguments for trade restriction and protection of domestic industries.
 - 3.4.4 Explain the role of the World Trade Organisation (WTO) in international trade.
 - 3.5 Discuss the macroeconomic environment of the business.
 - 3.5.1 Describe the main macroeconomic variables that governments seek to control.
 - 3.5.2 Explain what determines the level of economic activity and hence the overall business climate.
 - 3.5.3 Describe the effect on business output if a stimulus is given to the economy.
 - 3.5.4 Contrast actual and potential growth.
 - 3.5.5 Describe the factors that determine economic growth and explain the reasons for differences in different nations' growth rates.
 - 3.5.6 Discuss the relationship between economic growth and environmental sustainability.
 - 3.5.7 Describe why economies experience periods of boom followed by periods of recession and explain factors that influence the length and magnitude of the phases of a business cycle.
 - 3.5.8 Describe the causes and costs of unemployment and how unemployment relates to the level of business activity.
 - 3.5.9 Discuss the determination of the price level in the economy by the interaction between aggregate supply (AS) and aggregate demand (AD) in a simple AS-AD model.
 - 3.5.10 Describe the causes and costs of inflation and how inflation relates to the level of business activity.
 - 3.5.11 Explain what is meant by GDP and describe how it is measured.
 - 3.5.12 Discuss the representation of the economy as a simple model of the circular flow of income.
 - 3.6 Discuss what is meant by the balance of payments and how exchange rates are determined.
 - 3.6.1 Describe what is meant by 'the balance of payments' and how trade and financial movements affect it.
 - 3.6.2 Explain how exchange rates are determined and how changes in exchange rates affect business.
 - 3.6.3 Explain the relationship between the balance of payments and the exchange rates.
 - 3.6.4 Discuss the advantages and disadvantages of fixed and floating exchange rates.
 - 3.6.5 Explain how governments and/or central banks seek to influence the exchange rates.
 - 3.6.6 Describe the implications of such actions for other macroeconomic policies and for business.
 - 3.6.7 Describe the purpose and examine the effectiveness of monetary union and single currencies, with reference to the European Economic and Monetary Union, the Exchange Rate Mechanism and the creation of a single currency.
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- 3.7 Discuss the role of money and interest rates in the economy.
- 3.7.1 Describe the function of money.
 - 3.7.2 Describe what determines the amount of money in the economy, what causes it to grow and the role of banks in this process.
 - 3.7.3 Discuss the concept of the money multiplier in the real world.
 - 3.7.4 Describe how interest rates are determined.
 - 3.7.5 Explain the relationship between money and interest rates.
 - 3.7.6 Explain why central banks play a crucial role in the functioning of economies.
 - 3.7.7 Describe how a change in the money supply and/or interest rates affects the level of business activity.
- 3.8 Discuss the role, structure and stability of the financial system.
- 3.8.1 Describe the functions of the financial sector.
 - 3.8.2 Distinguish between the functions of investment funds, banks and insurance companies/pension funds.
 - 3.8.3 Describe the different ways banks and insurance companies can be exposed to credit risk and liquidity risks through:
 - bank loans
 - corporate bonds
 - securitisations (which can be owned by the non-bank sector)
 - syndicated loans
 - credit derivatives.
 - 3.8.4 Discuss why the banking sector is more likely to be exposed to systemic risk than the non-bank financial sector.
 - 3.8.5 Describe how financial innovation could lead to some functions of the banking sector being performed by non-banks.
 - 3.8.6 Describe the basic principles on which Islamic finance is based.
 - 3.8.7 Describe the features of one Islamic finance product and compare its features to the principles of Islamic finance.
- 3.9 Discuss what determines the level of business activity and how it affects unemployment and inflation.
- 3.9.1 Discuss how the equilibrium level of income is determined within a simple aggregate demand–expenditure model.
 - 3.9.2 Describe the concept of the multiplier and calculate its value.
 - 3.9.3 Describe the effect of a rise in money supply on output and prices.
 - 3.9.4 Describe the relationship between unemployment and inflation and whether the relationship is stable.
 - 3.9.5 Discuss how business and consumer expectations affect the relationship between unemployment and inflation and explain how such expectations are formed.
 - 3.9.6 Describe how a policy of targeting inflation affects the relationship between unemployment and inflation.
 - 3.9.7 Describe what determines the course of a business cycle and its turning points.
 - 3.9.8 Discuss whether the business cycle is caused by changes in aggregate demand or changes in aggregate supply (or both).
- 3.10 Assess how macroeconomic policies impact on businesses.
- 3.10.1 Describe the types of macroeconomic policy that are likely to impact on business and explain the way in which this impact takes effect.
 - 3.10.2 Describe the impact of fiscal policy on the economy and business and explain the factors that determine its effectiveness in smoothing out economic fluctuations.
 - 3.10.3 Describe the fiscal rules adopted by the government and discuss if following these rules is a good idea.
 - 3.10.4 Explain how monetary policy works in the UK and the Eurozone and describe the roles of the Bank of England and the European Central Bank.
 - 3.10.5 Explain how targeting inflation influences interest rates and hence the economic activity.
 - 3.10.6 Discuss the merits of following a simple inflation target as a rule for determining interest rates, and suggest an alternative rule.
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3.11 Assess how supply-side policies impact on businesses.

3.11.1 Describe the effect of supply-side policies on business and the economy.

3.11.2 Describe the types of supply-side policies that can be pursued and discuss their effectiveness.

3.11.3 Explain the impact on business of a policy of tax cuts.

3.11.4 Describe the major types of policy open to governments to encourage increased competition.

Assessment

Three-hour and fifteen-minute assessment using objective test questions and 'free form' answer questions.

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